Oversight Division

Committee On Legislative Research

SUNSET REVIEW

NEW MARKETS TAX CREDIT

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Prepared for the Committee on Legislative Research
by the Oversight Division

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Committee on Legislative Research Oversight Subcommittee

THE COMMITTEE ON LEGISLATIVE RESEARCH, Oversight Division, is an agency of the Missouri General Assembly as established in Chapter 23 of the Revised Statutes of Missouri. The programs and activities of the State of Missouri cost approximately $24.0 billion annually. Each year the General Assembly enacts laws which add to, delete or change these programs. To meet the demands for more responsive and cost effective state government, legislators need to receive information regarding the status of the programs which they have created and the expenditure of funds which they have authorized. The work of the Oversight Division provides the General Assembly with a means to evaluate state agencies and state programs.

THE COMMITTEE ON LEGISLATIVE RESEARCH is a permanent joint committee of the Missouri General Assembly comprised of the chairman of the Senate Appropriations Committee and nine other members of the Senate and the chairman of the House Budget Committee and nine other members of the House of Representatives. The Senate members are appointed by the President Pro Tem of the Senate and the House members are appointed by the Speaker of the House of Representatives. No more than six members from the House and six members from the Senate may be of the same political party.

Sunset reviews are assigned to the Oversight Division pursuant to Section 23.250 to 23.298. After August 28, 2003, any new program authorized by the General Assembly shall sunset not more than six years afer its effective date unless reauthorized by the General Assembly. The Oversight Division shall conduct a performance evaluation of the program as set forth in statute and prepare a written report. The report shall make recommendations on the sunset, continuation, or reorganization of a program

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The Joint Committee on Legislative Research is required by Section 23.259.1(3), RSMo to conduct performance evaluations of sunsetting programs to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation. The Oversight Division has reviewed the following programs:

- Surviving Spouse Tax Credit;
- Film Production Tax Credit;
- New Markets Tax Credit;
- After School Retreat Reading and Assessment Check Off;
- Missouri Teaching Fellows; and
- Healthcare Access Fund Tax Credit

The approved reports include Oversight's comments on (1) the sunset, continuation, or reorganization of the program, and on the need for the performance of the functions of the program; (2) the duplication of program functions; (3) the appropriation levels for each program for which sunset or reorganization is recommended; and possibly (4) drafts of legislation necessary to carry out the committee's recommendations pursuant to (1) and (2) above.

We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates. You may obtain a copy of the reports from the Oversight Division website at http://www.moga.mo.gov/htmlpages/losunsetreview.html.

Respectfully,

Brad Lager

Senator Brad Lager
Chairman

Chapter 1

Purpose/Objectives

The General Assembly has provided by law that the Joint Committee on Legislative Research will conduct a performance evaluation of a program subject to the Missouri Sunset Act. The committee is required to consider the criteria in Section 23.268, RSMo in determining whether a public need exists for the continuation of a program, or for the performance of the functions of the program. A sunset review is the regular assessment of the continuing need for a state program to exist, and a sunset review answers the basic questions of what has happened to the program since its inception and does the State of Missouri continue to "need" the services provided by the program.

The Joint Committee on Legislative Research directed the Oversight Division to conduct a Sunset Review of the Missouri Department of Economic Development's New Markets Tax Credit program, Section 135.680, RSMo. This report provides the Oversight Divisions's observations and comments on the Missouri New Markets Tax Credit Program as created by Senate Committee Substitute for House Committee Substitute for House Bill 1 in the 2007 First Extraordinary Session and fulfills the requirement as established by Section 23.268, RSMo.

The Oversight Division review addressed, but was not limited to the following:

1. Compiling and reviewing data related to the program since its inception.
2. Analyzing related events and changes to the program since its inception in 2007.

Scope

The Oversight Division researched the laws and activity regarding the Missouri New Markets Tax Credit Program from 2007 through 2012. The analysis included a review of information provided by the Department of Economic Development related to the program.

Methodology

The Oversight Division obtained information on the Missouri New Markets Tax Credit Program through review of statutes, letter correspondence with the Missouri Department of Economic Development (DED), review of supporting information filed with DED, and interviews with DED and DOR staff regarding the program.

Background

Senate Committee Substitute for House Committee Substitute for House Bill 1 from the First Extraordinary Session in 2007 created the Missouri New Markets Tax Credit program. The state program was created to bring more projects from the federal New Markets Tax Credit to the state.

The enabling legislation (Section 135.680 RSMo) allowed tax credits for investments made on or before June 30, 2010, and stipulated that the program automatically sunset six years from its effective date. No changes have been made to the investment deadline or the sunset language since the enabling legislation was passed. Therefore, with an effective date of September 4, 2007, the credit is scheduled to expire on September 4, 2013.

Department of Economic Development

The Missouri Department of Economic Development (DED) is the primary state agency devoted to the state's programs for business and community development.

DED is composed of divisions, boards, and commissions which execute statutory requirements, develop program regulations, and implement policy in the areas of community, economic, and workforce development. The divisions, boards, and commissions work with businesses and communities to help firms create jobs, increase sales, find and train qualified workers, identify sites, and obtain financial support to locate or expand in Missouri, promote capital investment, and increase the self-sufficiency of communities in the state.

The Department of Economic Development, Division of Business and Community Services (BCS) offers programs and incentives for businesses and communities to create a pro-business climate and strong community partnerships where businesses can thrive. BCS is also the administrative agency for seven of the eight active tax credit programs, including the New Markets Tax Credit program, which were created by the General Assembly to encourage business development in the state.

Department of Revenue

The Missouri Department of Revenue (DOR) serves as the central collection agency for all state revenues. The department's primary duties include collecting taxes, titling and registering motor vehicles, and issuing driver licenses. DOR administers a number of tax credit programs which are claimed directly on a taxpayer's filed return, and DOR also redeems tax credits administered by other state agencies when they are submitted in lieu of payments by Missouri taxpayers.

Chapter 2

Comments

Oversight notes that the Missouri New Markets Tax Credit program is very similar to the federal program, and a project submitted to the Missouri program must have been approved for the federal program. There are minor differences between the federal and state programs as to the type of projects which are eligible, and there are differences in the timing of tax credit issuance.

Federal Program

The federal New Markets Tax Credit (NMTC) program was established as part of Section 45D of the Internal Revenue Code by the United States Congress in the Community Renewal Tax Relief Act of 2000. The federal program was intended to spur new or increased investment in projects located in designated low-income communities, and it provides credits against federal income taxes in exchange for equity investments in those projects.

Tax credits under the federal program are allocated to various Community Development Entities (CDE) by the Community Development Financial Institutions Fund (CDFI Fund) organization which is a part of the United States Department of the Treasury. The CDFI Fund was created by the Riegle Community Development and Regulatory Improvement Act of 1994, for the purpose of promoting economic revitalization and community development through investment in and assistance to Community Development Financial Institutions (CDFIs).

Investors in approved projects are required to make their qualifying investments through specialized financial institutions called Community Development Entities (CDE) which make the actual investment in the new businesses. In order to participate in the federal program, the CDE must first be certified as a Community Development Entity (CDE) by the CDFI Fund organization. The CDFI Fund organization provides financial and technical assistance for the creation of a CDE in addition to managing its economic development and financial incentive programs.

To qualify as a CDE, an organization must:

* Be a domestic corporation or partnership at the time of the certification application;

* Demonstrate a primary mission of serving, or providing investment capital for, low-income communities or low-income persons; and,

* Maintain accountability to residents of low-income communities through representation on a governing board of or advisory board to the entity.

Upon completion of the project, the CDE receives the federal tax credits and passes them through to the investors. The tax credits are calculated at 39 percent of the approved investment amount and can be claimed over a period of seven years (five percent for each of the first three years and six percent for each of the remaining four years). If the original investment in the CDE is redeemed before the end of the seven-year period the tax credits are subject to recapture.

The CDFI Fund has made 664 federal tax credit awards nationwide through 2011, allocating a total of $33 billion in tax credit authority to CDE through a competitive application process. The $33 billion total included $3 billion in Recovery Act awards and $1 billion of special authority for the recovery and redevelopment of the Gulf Opportunity Zone after Hurricane Katrina. The federal NMTC program expired on December 31, 2011, with a carryover period that was scheduled to end in 2016; however, on July 13, 2012 the CFDI fund announced that an additional $5 billion in tax credits would be available for 2012.

As shown in Table 1 below, the CDFI Fund awarded over $1.5 billion in federal tax credits to Missouri projects through 2011.

Table 1:
Federal New Market Tax Credits Awarded to Missouri projects

Year	Amount
2003	$52,000,000
2006	$195,000,000
2007	$290,000,000
2008	$215,000,000
2009	$420,000,000
2010	$144,000,000
2011	$220,000,000
Total	$1,536,000,000

Source: CDFI Fund website

State Program

In 2007, the General Assembly created the Missouri New Markets Tax Credit Program to provide supplemental funding for investment entities in Missouri that were approved for the federal program. Like the federal program, the Missouri program provides tax credits for investments in approved Community Development Entities (CDE), which in turn make investments in eligible projects located in low income census tracts in Missouri. Only CDE's that have been approved for the federal program are eligible to apply for the state program; the state program was intended to attract more funding to Missouri projects and encourage the development and funding of NMTC projects in eligible Missouri locations.

The state application process is in two parts:

1. The CDE submits an application to the Department of Economic Development. The application includes the state NMTC form, a copy of the CDE's Allocation Agreement, and copies of maps of the allocation area.

2. When the CDE is determined to be eligibile, DED sends a preliminary approval letter to the applicant CDE. The preliminary approval letter includes an estimate of the amount of NMTC reserved for the project, contingent upon qualified investments being made within 30 days after the date of the letter.

When the CDE submits the proof of investment, the project and the CDE become eligible for tax credits. If an approved CDE is not able to provide documentation for the qualifying investment within 30 days of the preliminary approval letter, the CDE is required to reapply, and is also required to provide documentation of a formal commitment to secure the investment with its second application.

The Department of Economic Development has authorized tax credits for the state NMTC program as shown in Table 2 below.

Table 2:
Missouri New Market Tax Credits

FISCAL YEAR	AMOUNT AUTHORIZED	AMOUNT ISSUED
2007	$0	$0
2008	$51,441,000	$0
2009	$21,684,000	$8,708,000
2010	$47,580,001	$14,369,000
2011	$0	$22,105,000

Source:
Department of Economic Development

The Missouri program cap in Section 135.680.2 RSMo requires DED to limit the amount of qualified equity investments in the program to a level which would result in tax credit utilization of no more than twenty-five million dollars in a fiscal year. DED officials provided Oversight with an analysis of projected tax credit redemptions which indicates that tax credits available for redemption for this program do not exceed $25 million per year. Carryover of unused credits could result in actual redemptions in excess of the $25 million annual limit.

Oversight reviewed a sample of the files that DED maintains for this program. Oversight noted that the files were complete and organized, and included a checklist to document receipt of required documents from the CDE as well as copies of the application forms, a copy of the contingent allocation letter, a copy of the proof of investment, a copy of the final allocation letter, and supporting documents.

Differences Between Federal and State Programs

The Missouri program excludes any business that derives or projects to derive fifteen percent or more of its annual revenue from the rental or sale of real estate. Those projects could be eligible for federal but not Missouri tax credits. The Missouri program also provides for the delayed issuance of tax credits; no credit for each of the first two federal credit allowance dates, seven percent for the third credit allowance date, and eight percent for the next four credit allowance dates. As noted above, the federal program allows five percent of available credits to be claimed in each of the first three years, and six percent for each of the remaining four years.

Comments

1. Extension of the program

Oversight has noted that this program was intended to supplement the federal NMTC program, in order to encourage projects to be developed and funded in Missouri. The federal program has expired and been extended several times and most recently expired on December 31, 2011; however, the federal agency which administers the program has announced the availability of tax credits for 2012.

Tax credits under the state program were limited to qualified equity investments made on or before June 30, 2010; therefore, funding for the program has stopped. The program was scheduled to sunset on September 4, 2013, and the General Assembly has not extended funding or reauthorized the program.

2. Tax Credit Accountability Act Compliance

The Missouri Tax Credit Accountability Act (Act) , in Section 135.800.2(12) RSMo, designated the New Markets Tax Credit Program as a redevelopment tax credit for which annual reporting is required for three years after the issuance of tax credits. Information provided by the Department of Economic Development indicated that the last tax credits under this program would be issued during the year ending June 30, 2016, which would indicate that reporting and monitoring should be extended until June 30, 2019.

The Act requires project owners to submit annual reports to the Department of Economic Development which include:

- The usage of the property; whether for residential, commercial, or governmental purposes;
- The projected or actual project cost;
- The labor cost; and
- The date of completion.

The Act requires the Department of Economic Development (DED) to collect information on projects which receive tax credits, and to make that information available for public inspection on the department's website and the Missouri Accountability Portal.

Oversight found the required information for New Markets Tax Credit Program on the Missouri Accountability Portal but we were not able to locate any information on these projects on the DED website or in the DED annual report on tax credits.

3. Supervision and Monitoring

As we have noted above, the program allowed a project in the federal program to qualify for Missouri tax credits on projects in Missouri. The program also makes Missouri tax credits subject to recapture if the project no longer qualifies for the program or if federal tax credits are recaptured.

We found no provisions allowing or requiring the Department of Economic Development or the Department of Revenue to verify the existence or continued eligibility of these projects for the tax credit financing they received. Officials from the Department of Economic Development and the Department of Revenue confirmed that they had not developed procedures to review or verify the continuing existence or eligibility of the funded projects. In addition, officials from the Department of Revenue told us there was not a process in place to provide notification to the state if a project in the federal NMTC program failed or was otherwise required to repay tax credits.

Recommendations

1. Program Sunset

Oversight notes that the General Assembly has already terminated funding for this program, and the program will be sunset without specific action by the General Assembly. Oversight recommends the program be extended through June 30, 2019 to allow for the continued administration of outstanding tax credits and to facilitate proper supervision and management of the program.

2. Statutory Authority for Supervision and Monitoring of Projects.

Oversight recommends the General Assembly provide appropriate authority for the Department of Economic Development and the Department of Revenue to supervise and monitor the projects which were funded under this program until the recapture provisions expire, and assign responsibility for program monitoring to those departments. The monitoring authority and requirements could potentially be added to the Tax Credit Accountability Act and made applicable to other tax credit programs which have similar recapture provisions.

3. Supervision and Monitoring Procedures

Oversight recommends the Department of Economic Development and the Department of Revenue develop supervision and monitoring procedures for this program and similar tax credit programs, and publish any regulations determined to be necessary to maintain adequate supervision of funded projects and to recapture credits issued to projects which fail or otherwise become ineligible for tax credits.

3. Tax Credit Accountability Act Reporting

Oversight recommends the Department of Economic Development expand their reporting on tax credit programs as required by the Tax Credit Accountability Act.